

SUMMARY ANALYSIS OF AMENDED BILL

Author: Lewis & Schiff Analyst: Kristina North Bill Number: SB 1499

Related Bills: See previous analysis Telephone: 845-6978 Amended Date: 4/21/98

Attorney: Doug Bramhall

Sponsor:

SUBJECT: Gain Or Loss From Sale Of Principal Residence/Discharges From Indebtedness

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

☒ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _____.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO _____.

☒ REMAINDER OF PREVIOUS ANALYSES OF BILL AS INTRODUCED FEBRUARY 5, 1998, AND AS PROPOSED TO BE AMENDED (4/13/98), STILL APPLIES.

☒ OTHER - See comments below.

SUMMARY OF BILL

Under the Personal Income Tax Law, this bill would allow a taxpayer, when determining the amount realized upon the sale or other disposition of property, to elect to include the amount of acquisition indebtedness discharged in connection with a short-sale of the taxpayer's principal residence.

The April 21, 1998, amendment removed "home equity indebtedness" from the definition of "qualified residential indebtedness."

The April 13, 1998, amendment replaced the exclusion from gross income of any income from the cancellation of secured indebtedness in the case of the sale of a taxpayer's principal residence with the above language.

Except for these changes and the revenue estimate, the department's prior analysis of the bill "as proposed to be amended," still applies.

Tax Revenue Estimate

Based on data and assumptions discussed below, this bill would result in revenue losses under the Personal Income Tax Law as shown below:

DEPARTMENTS THAT MAY BE AFFECTED:

___ STATE MANDATE

___ GOVERNOR'S APPOINTMENT

Board Position:

___ S ___ O
___ SA ___ OUA
___ N ___ NP
___ NA ___ NAR
___ X ___ PENDING

Agency Secretary Position:

___ S ___ O
___ SA ___ OUA
___ N ___ NP
___ NA ___ NAR
DEFER TO _____

GOVERNOR'S OFFICE USE

Position Approved ___
Position Disapproved ___
Position Noted ___

Department/Legislative Director Date
Johnnie Lou Rosas **5/7/98**

Agency Secretary Date

By: Date:

Estimated Revenue Impact of SB 1499 As Amended 4/21/98 [\$ In Millions]		
1998/99	1999/00	2000/01
(\$4)	(\$2)	(\$2)

The bill would be effective for taxable years beginning on or after January 1, 1998, with enactment assumed after June 30.

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

Tax Revenue Discussion

The revenue impact of this bill would be determined by (1) the number of short sales of principal residences within a given year, (2) the amount of canceled "qualified residential indebtedness" (excluding home equity indebtedness) from such sales, (3) the number of taxpayers that elect to add discharged acquisition indebtedness to the amount realized upon the sale, and (4) the average marginal tax rate of taxpayers making an election. In any given year, the changing real estate market conditions and other economic conditions would influence the magnitude of potential losses.

The following is based on information provided by staff at the California Association of Realtors:

- For 1997, sales of residential properties totaled 555,380.
- Short sales peaked in 1994, at nearly 8% of total sales. Since 1994, short sales as a percentage of total sales have declined each year. In 1997, short sales were 4.6% of total sales.
- Approximately three-quarters of total sales are sales of principal residences. (The other one-quarter of sales represented sales of second/vacation homes and rental/investment homes.)
- For 1997, the average net loss to sellers per short sale was approximately \$8,000.

For 1998, it is assumed that short sales will drop to 3.7% of total residential sales (a 20% reduction from 1997). Multiplying the projected number of short sales of principal residences times the average net loss per short sale in 1997 derives a projection of debt canceled for 1998 of roughly \$125 million. Multiplying the \$125 million times (a) a two-thirds assumption for "acquisition indebtedness" to exclude home equity indebtedness, (b) an assumed 6% marginal tax rate, and (c) a 10% insolvency exception derives an estimated liability year loss of \$4.5 million. (The insolvency exception is a current law exclusion from gross income for debt discharged when the taxpayer is insolvent.) Subsequent liability year losses reflect additional assumptions for (1) increasing mortgage debt outstanding and (2) potentially improving real estate market conditions.